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The EU Defence Market Directives: Genesis, Implementation and Way Ahead

by Alessandro Marrone and Michele Nones

ABSTRACT

The 2009 directives on defence procurement (2009/81) and intra-EU transfers (2009/43) were adopted after a delicate process led by the European Commission and influenced by the member states. As a result, they present significant limits and weaknesses. Over the last decade, their implementation has been difficult, slow and partial, bringing inadequate results. In particular, exemptions to Directive 2009/81 are excessively used, while national controls over intra-EU transfers have not been sufficiently simplified nor reduced by Directive 2009/43. The most appropriate way ahead is an update of both directives through a new and better enforceable EU legislation. This would bring several advantages to both armed forces and industries in the Union, and benefit the European quest for strategic autonomy.

keywords

European Union | Defence industry | Military procurement | Arms trade | European Defence Fund

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The EU Defence Market Directives: Genesis, Implementation and Way Ahead

by Alessandro Marrone and Michele Nones*

1. The delicate genesis of the 2009 directives

In order to better evaluate the 2009 EU directives on procurement (2009/81)[1] and intra-community transfer (2009/43),[2] it is important to recall their elaboration process. Indeed, the directives' background helps to understand not only their rationale, but also the limits that had to be accepted from the beginning to find the necessary consensus of member states.

The March 2003 Commission's Communication was the starting point. Its title clearly expressed the start of a process "Towards an EU defence equipment policy".[3] Three elements were particularly important. First, to recognise for the first time in the EU history the specificity of the defence market, which means the rules of civilian markets cannot be directly applied to it. Until then, the application of civilian regulations was formally required but in practice seldom implemented. The communication represented a more realistic approach: it reduced the expectation in comparison with the functioning of the single market, but forced the defence reality to meet such expectations in terms of greater openness and competition.

[1] European Parliament and Council of the European Union, *Directive 2009/81/EC of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security...*, http://data.europa.eu/eli/dir/2009/81/2020-01-01.

[2] European Parliament and Council of the European Union, *Directive 2009/43/EC of 6 May 2009 simplifying terms and conditions of transfers of defence-related products within the Community*, http://data.europa.eu/eli/dir/2009/43/2019-07-26.

[3] European Commission, *European defence - Industrial and market issues - Towards an EU Defence Equipment Policy* (COM/2003/113), 11 March 2003, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52003DC0113.

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This document has been prepared on the basis of Michele Nones' participation in the Shadows' exchange of views with experts conducted by the European Parliament on the Implementation of Directive 2009/81/EC, concerning procurement in the fields of defence and security, and of Directive 2009/43/EC, concerning the transfer of defence-related products. The views expressed are solely of the two authors and do not represent any institution.

A second important element was its comprehensive approach. All the relevant aspects of the defence market were listed, pointing out initiatives to encourage the construction of a more "EU" and less "national" European market.

Thirdly, the communication announced two initiatives. An Interpretative Communication to define the scope of Article 296 (now article 346 TFUE) by the end of 2003, and a Green Paper on Defence Procurement in 2004 as a basis for discussion with stakeholders. A way ahead was charted.

Then, the need to find consensus among member states and stakeholders forced the Commission to carry out a long consultation. The results were presented in the Communication of December 2005. It stated the necessity for an Interpretative Communication of Article 296 because "the application of the derogation remains problematic". It also announced the possibility of a specific Directive "for the procurement of defence goods (arms, munitions and war material) and services".[4]

In December 2006 the Interpretative Communication of the Commission on the application of article 346 "in the field of defence procurement" was published.[5] The overarching goal was to push member states to accept more competition in the defence market, reducing the share protected by the extensive use of that article. Unfortunately, the Commission was unable to modify the list of products defined back in 1958. The old list is too general as only the type of products is mentioned, thus allowing a very broad use of the exclusion clause. Not modifying the 1958 list represents one of the main limits of the directives' elaboration process.

In December 2007 a new Communication was published.[6] Two directives were announced, respectively on defence procurement and intra-community transfers. These Commission's steps were instrumental to the adoption of the directives, because the EU trend toward greater obligation to increase competition had, de facto, prompted many member states to accept a regulatory intervention of the Commission as a necessary evil, since they were in any case becoming less able than before to count on the exemption of Article 296.

[4] European Commission, *On the results of the consultation launched by the Green Paper on Defence Procurement and on the future Commission initiatives* (COM/2005/626), 6 December 2005, p. 9-10, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52005DC0626.

[5] European Commission, *Interpretative communication on the application of Article 296 of the Treaty in the field of defence procurement* (COM/2006/779), 7 December 2006, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52006DC0779.

[6] European Commission, *A strategy for a stronger and more competitive european defence industry* (COM/2007/764), 5 December 2007, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52007DC0764.

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2. The critical aspects of the two directives

The two directives have been designed as a "defence package" because they are conceptually interdependent. Indeed, it is not possible to integrate the defence market without a common regulation of both the purchases by member states and the intra-community transfers. The common rationale is to encourage access by non-national companies to each and every procurement across the EU.

Unfortunately, the two directives born with some weaknesses. First, the Commission did manage them separately, through two Directorates General (respectively Market and Industry) and two Working Groups of member states. In particular, the first group on procurement was formed by the experts of the Ministries of Defence, while the second one on intra-community transfer by those of the different national bodies responsible for monitoring the export. Therefore, the latter was not very aware on the need of greater competition, bearing the mindset of the controllers.

In particular, the procurement directive had to face three critical aspects: (1) the area of application; (2) the need to protect intergovernmental collaborations – cooperative procurement programmes, Government-to-Government (G2G) deals, NATO projects, OCCAR agreements, etc. –; (3) the need to somehow "compensate" countries with small industrial capacities by recognising the possibility of imposing competition for sub-contractors and, therefore, favouring their companies – mostly small and medium-sized enterprises (SMEs) – in the procurement awarded to non-national suppliers.

The intra-community transfers directive had to find a balance between the objective of defining an EU-wide legislation and the member states' will to protect their national prerogatives. In this context, the following four aspects were particularly critical:

1. the list of products of the General Licence is established at national level, for both companies and armed forces;
2. the certification of medium/large enterprises able to receive products under a General Licence is also established at national level;
3. the lack of specific legislation to manage intergovernmental cooperative programmes, including the export of the equipment jointly produced;
4. the absence of measures for the coordination of national exports to third countries.

3. A slow, difficult and partial implementation

More than ten years later, several issues remain on the table with regards to both directives.

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Concerning Directive 2009/81 on procurement, the main problems emerged in the past decade are related to the systematic use of exclusions. Despite the Commission's efforts to constantly consult member states and to prepare interpretative notes (2016/C 450/01 and 2019/C 157/01),[7] this problem is not solved.

Moreover, the directive' provisions on subcontracting can be largely considered a failure. There were many expectations in these regards. Those provision were meant to counteract the offsets practice that several member states with small industrial capacities used to implement. The idea was to build a system allowing the creation of a European supply chain in the defence and security sectors. To do so, it was necessary to open up the separated, national supply chains – hence the provisions on subcontracting were conceived. However, they could succeed only within a truly integrated European market allowing an easy exchange of parts and components (mostly produced by SMEs). This latter condition has not been realised, and the provisions are not really implemented.

Finally, the financial and economic crisis erupted exactly at the time of the directives publication has prompted many member states to continue protecting their defence industries. Unfortunately, such a protectionist approach may be favoured again by the post-COVID economic crisis.

As regards the Directive 2009/43 on intra-community transfers, there is a general lack of harmonisation and implementation which impedes the functioning of the internal market on defence-related products. The main problems relate to the insufficient use of the General Licence and the certification system.

Actually, simplification of controls cannot be effectively designed by those national authorities tasked of maintaining the maximum possible national control over what several member states continue to consider exports and not transfers (even statistically, in several European countries this trade falls in the "export" category). It is a matter of institutional culture: usually controllers are not keen to reduce controls as they are mostly concerned about possible risks, even if these risks are non-existent or marginal as in the case of the intra-community transfers. It is also a matter of bureaucratic politics: simplified controls mean a reduction of competences and powers for the controllers.

As a whole, the positive results achieved so far by the directives are insufficient, and the national markets within the EU do not guarantee sufficient competition. Such situation implies negative consequences for the industry, the armed forces and broadly speaking the European defence and security.

[7] European Commission, *Commission Notice – Guidance on the award of government-to-government contracts in the fields of defence and security* (2016/C 450/01), 2 December 2016, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016XC1202(01); and *Commission notice on guidance on cooperative procurement in the fields of defence and security* (2019/C 157/01), 8 May 2019, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0508(01).

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4. An ambitious way ahead

The two directives should be re-connected, especially with a view to ensuring an effective EU-wide level playing field. Moreover, their possible impact on the cooperative programmes defined within the European Defence Fund (EDF) and Permanent Structured Cooperation (PESCO) should be studied in order to avoid the creation of any obstacle to these important EU defence initiatives. In particular, EDF is the main tool that the Union can use to strengthen the European Defence Technological Industrial Base (EDTIB). The Fund will be able to encourage the spread of competitive, state of the art European equipment among an increasing number of member states' armed forces. To get to a common European defence market, economic incentives are strongly needed together with common rules. Being a substantial financial bonus, the EDF can give a significant push in this direction.

Therefore, provisions regarding the cooperation on research and development (R&D) should be adjusted in order to support this EDF role. Indeed, it is likely that after funding an EDF/PESCO project, if the results are positive, the participating countries will also finance the production phase. A first step is to allow all member states to purchase the equipment funded through the EDF without issuing a procurement competition. In other words, the exemption from the 2009/81 directive would turn to be an incentive to buy European rather than buy national, thus maximising integration of supply chains and defence market.

At the same time, the directives' impact on EU–UK cooperation should be considered, bearing in mind the industrial and intergovernmental collaboration in place between London and several member states, as well as the presence of transnational defence companies (TDCs) across the Channel (i.e. in the missile sector). Brexit implications in the defence field are deep, diverse and long term. As such, they require a specific agreement between the EU and the UK to ensure continued collaboration at intergovernmental and industrial level, including with regards to directives implementation.

Concerning directive 2009/81, member states are still struggling with its implementation despite the Commission's guidance and recommendations. It seems to be that the EU has done almost everything possible to fully exploit and implement this directive. The two main problems are represented by the text of the directive itself, especially the part on the exclusions, and by the Commission's prudence in contesting its extensive use by some member states up to the European Court of Justice. Therefore, the solution should be sought by updating directive 2009/81, also in light of the experience of these eleven years.

Directive 2009/43 should be updated too. For instance, SMEs are penalised by current legislation, mainly because it does not simplify the excessive and numerous controls on intra-EU defence trade. The solution should be sought by letting components and technologies to lose their national "identity" once they are

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integrated into more complex equipment. The only condition for a total exemption from transfer controls could be that their value does not exceed a certain share of the complete system (for example 20 per cent). This would positively contribute also to common export policy by removing some veto powers within cooperative programmes.

Obviously, intra-community transfers are related to extra-EU exports of the equipment produced in the Union. Exports to third countries are and remain responsibility of the member states. Therefore, the construction of a European export policy in this field should be strengthened through greater cohesion by the very same member states. Such a cohesion should be achieved in the framework of 2008 EU Council Common Position defining common rules governing control of exports of military technology and equipment (2008/944/CFSP).[8]

Broadly speaking, the update of both directives should take into account the changing industrial landscape at global level and the EU goal of strategic autonomy. In the defence market, the Union should favour industrial concentration in sectors still too fragmented, such as shipbuilding, armoured vehicles, unmanned systems, several kinds of electronic equipment. The competition takes already place at the global level, it is increasingly fierce and witnesses not only US but also Chinese and Russian giant competitors penetrating a number of markets. Therefore, there is no significant risk of negatively decreasing competition in the defence market in Europe. On the contrary, the risk for Europeans is to become less able to compete worldwide. Technological sovereignty should be pursued at EU level, accepting an increasing interdependence of member states. This would lead to greater concentration and specialisation of domestic producers. Altogether, this process could actually build on good praxes already developed in the US, which have achieved a good balance between concentration and competition. In the end, such process would definitively help EU to reach an appropriate level of strategic autonomy.

After updating the directives, it will be crucial a better control of their application also by taking the necessary enforcement measures. Obviously, concerning defence procurement, such control and enforcement would greatly benefit by an updated legislation more rigid, strict and clear on the exclusions. A definitive solution would be to elaborate new, more detailed and limited list of military products for which member states can invoke the exemptions. Accordingly, the 2006 Interpretative Communication should be updated, also on the basis of experience gained in more than a decade.

In conclusion, updating and then fully implementing the directives is necessary and appropriate to definitively overcome those aspects of national industrial

[8] Council of the European Union, *Council Common Position 2008/944/CFSP of 8 December 2008 defining common rules governing control of exports of military technology and equipment*, http://data.europa.eu/eli/compos/2008/944/2019-09-17.

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policies that contribute to maintain an artificial fragmentation of the EU market, and therefore prevent it to become more efficient, innovative and prosperous with a number of benefits for the Union.

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